

AGENDA
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Monday, May 19, 2008, at 9:00 a.m.
State Capitol Building, Room 303
Helena, MT

PRESENT: Governor Brian Schweitzer, Attorney General Mike McGrath, Superintendent of Public Instruction Linda McCulloch, Secretary of State Brad Johnson, and State Auditor John Morrison

Mr. McGrath moved for approval of the minutes from the April 21, 2008, meeting of the Board of Land Commissioners. Seconded by Mr. Johnson. Motion carried unanimously.

BUSINESS CONSIDERED:

508-1 FWP: GRANGER RANCH WETLAND CONSERVATION EASEMENT

Ms. Sexton stated this is for a conservation easement on an acquisition by FWP. It is for 225 acres located six miles south of Ennis, on land that was donated by a private landowner.

Mr. Paul Sihler, FWP Field Services Division Administrator, stated this project is part of a restoration effort on O'Dell Creek that will create 16 new acres of wetlands and restore several miles of the creek. It will benefit the spawning of rainbow and brown trout, upland and migratory birds, and serve as a source of coldwater discharge to the Madison River. The Granger Ranch is under a conservation easement which does not cover the restoration activities, so an additional easement is needed to maintain the integrity of the restoration work required by the funding source. An EA was completed and approved by the FWP commission on May 15, 2008. Thirteen comments were received, with twelve in support and one expressing concern about a lack of open access. The Granger Ranch does allow hunting access and there were over 100 hunting permits granted last year for the harvesting of elk, antelope, and deer.

Motion was made by Ms. McCulloch for approval of the conservation easement. Seconded by Mr. McGrath.

Governor Schweitzer stated that he had been to the property, and that it is amazing for its location and proximity to the Madison River. The easement is a great opportunity to expand the protected wetlands as urban development in the valley encroaches.

Motion carried unanimously.

508-2 FWP: OLSEN RANCH CONSERVATION EASEMENT

Ms. Sexton stated that this conservation easement is for 612 acres in Valley County and was purchased from a private landowner for \$452,000 with funding supplied by the Habitat Montana Program.

Mr. Sihler stated that this easement is part of the Milk River Initiative, which is part of a broader set of projects to conserve critical habitat along the Milk River. The project would conserve three miles of riparian habitat and benefit waterfowl, migratory songbirds, upland game birds, and whitetail deer; provide a minimum of 300 days annually perpetual hunting access; and help to sustain a family farm and ranch. An EA was performed and approved by the FWP Commission on May 15, 2008. Eight comments were received: seven in support and one opposed. The opposition was from a neighbor who formerly owned the property and was

MAY 19, 2008
LAND BOARD MINUTES

concerned about the value and inflated prices. The price was based off an appraisal that had been recently completed on an adjacent property, paying 45 percent of market value, equal to the appraisal value on the adjacent easement. The other concern was in regards to the 100 hunter days of access. Mr. Sihler stated the 100 days in the easement are the minimum, and that there are often hunting use days that exceed the minimum required in an easement.

Motion was made by Mr. Johnson to approve the conservation easement. Seconded by Mr. McGrath. Carried unanimously.

508-3 AGRICULTURE AND GRAZING COMPETITIVE BID HEARINGS

Ms. Sexton stated that a competitive bid hearing for lease numbers 9701 and 3121 was held on May 1, 2008, to determine the lease rate for the agriculture and grazing leasing term. The criteria for these hearings are laid out in ARM rules. The first of hearing was for lease 9701, Jim and Mary Ann Parrent, in Sweet Grass County. The high bidder was Mr. Noll at \$36.94 per AUM. The DNRC recommended the next 10-year lease be issued to Jim and Mary Ann Parrent for \$17.80 per AUM which is the statewide average rate. It is a small lease of 160 acres and \$17.80 per AUM reflects the prevailing community standard. Ms. Sexton praised the Parrents for their past history of land stewardship and range management.

The second hearing was for lease 3121, Lon and Stacey Waid, in Hill County. The Waids currently pay the state basic AUM rate, while the high bid was \$16.94 per AUM. This isolated parcel of land has been leased by the Waid family for some time. There is a considerable amount of timber on the property and the Waids have done an excellent job of stewarding the land with the "take half/leave half" approach. The DNRC recommended the next lease term be issued to the Waid family for \$14.00 per AUM which is an average between the county and statewide rates and reflects the prevailing standard.

Motion made by Mr. McGrath to approve the lease rates for Jim and Mary Parrent and Lon and Stacey Waid. Seconded by Mr. Johnson. Carried unanimously.

Mr. Johnson stated that competitive bid hearings provide an opportunity to exercise judgment for what is best for the land and reiterated his support for the motion.

508-4 TIMBER SALES:

Item 508-4 was considered as a single block.

508-4A CLIFF LAKE TIMBER SALE

Ms. Sexton stated that this timber sale of 3.3 MBF is for 472 acres, ten miles northwest of Kalispell, and is part of an intermediate thinning project. A small amount of new construction would be required and existing roads would be maintained.

508-4B FLOWER CREEK TIMBER SALE

Ms. Sexton stated that this timber sale is two air miles south of Libby for 3.5 MBF over 352 acres and is part of the wildland-urban interface. Some concern about smoke being generated from slash burning was expressed. The DNRC will use additional methods such as chipping or grinding to address the slash. These measures are currently required for many timber sales.

MAY 19, 2008
LAND BOARD MINUTES

508-4C FORT PINKHAM TIMBER SALE

Ms. Sexton stated this sale is out of the Stillwater Unit with 3 MBF over 370 acres. Fourteen acres of old growth are on the parcel, but because of the high degree of mortality resulting from the Douglas fir bark beetles, if the area is not treated it would lose its old growth status. the proposed sections are also within the wildland-urban interface and are considered a fuels reduction project. There was concern with a landowner regarding the use of a road. The DNRC will harvest that area during the winter using a temporary snow road to avoid encumbering the property with an easement.

508-4D SLEEPING CHILD TIMBER SALE

Ms. Sexton stated this sale is out of the Hamilton Unit for 369 MBF over 202 acres with no old growth. The objective is to remove dying ponderosa pine and Douglas fir to promote a healthier timber stand.

Jason Todhunter, Montana Logging Association, gave support for the four timber sales, and encouraged the continuation of the timber program. The MLA annual meeting had just concluded, and despite the challenging market, the DNRC's contribution of 53.2 MBF has done a great deal to maintain the timber industry infrastructure in Montana.

Motion made by Mr. Johnson to approve 508-4A through 508-4D. Seconded by Ms. McCulloch. Carried unanimously.

508-5 PROPOSED LAND BANKING RULE AMENDMENTS

Ms. Sexton stated this is for final approval of the land banking administrative rule amendments.

The amendments are due to the passage of SB131 during the 2007 legislative session and do the following:

- ♦ Extend the land banking program to 2011 (77-2-363, MCA).
- ♦ Shorten the number of days prior to auction that bid deposits must be received from 45 days to 20 days (77-2-363, MCA).
- ♦ Change the bid bond from 50 percent to 20 percent (77-2-363, MCA).
- ♦ Provide for the collection of funds from the prospective purchaser prior to the state incurring the cost of sale related expenses (77-2-363, MCA).
- ♦ Increase the accounting period on forested lands from 20 years to 60 years (77-2-364, MCA).

Following approval by the Land Board, the adoption notice will be filed with the Secretary of State's Office and the rules will become effective June 13, 2008.

Motion made by Mr. McGrath for final approval of the land banking rule amendments. Seconded by Mr. Morrison. Carried unanimously.

508-6 PRELIMINARY APPROVAL FOR SALE OF LAND BANKING PARCELS

Item 508-6 was considered as a single block.

MAY 19, 2008
LAND BOARD MINUTES

508-6A CENTRAL LAND OFFICE (3177.27 ACRES)

Ms. Sexton stated that there are a number of parcels in Beaverhead County that have legal access which are adjacent to the I-15 and surrounded by private land. The odd configuration of the parcels makes DNRC management difficult and expensive. One comment was made regarding access to an historical use road. If this road were determined to have legal public access the road would be acknowledged regardless of ownership. A parcel in Broadwater County is surrounded by a conservation easement. It is a small parcel that is difficult for the DNRC to manage. The owner of the surrounding lands has indicated his intention to add a conservation easement to this parcel, should he purchase it. There was a request to perform a GPS on the location in Madison County. However, the DNRC reviewed the quadrant map, which indicated that there is a corner marker, so there is no need for GPS.

508-6B EASTERN LAND OFFICE (128.6 ACRES)

Ms. Sexton stated that the parcel in Carter County is a small, isolated grazing parcel with no public access. The parcel in Custer County has access from a county road which is within the airport restriction area.

508-6C SOUTHWESTERN LAND OFFICE (943.15 ACRES)

Ms. Sexton stated there was concern in Powell County that the landowner has a conservation easement on the surrounding property. In Missoula County there was concern over the loss of open space, including a comment from FWP expressing concern over loss of wildlife in this area. Ms. Sexton noted that as the area is being readily developed, any sale would be subject to approval under state and local regulations.

Motion made by Mr. McGrath to approve 508-6A through 508-6C. Seconded by Mr. Johnson.

Mr. Morrison referenced the concerns expressed by the Ninemile Wildlife Working Group and inquired if any development in the area would be subject to review by state and local regulations?

Ms. Seton said yes.

Mr. Morrison asked if there would be further considerations of those concerns before any development occurred?

Ms. Sexton said yes and reiterated that this is for preliminary approval only. The DNRC will be looking for opportunities for working with the local governments and surrounding landowners as the process moves forward.

Motion carried unanimously.

508-7 APPROVAL FOR COMMUNITIZATION AGREEMENT – ATHENA ENERGY LLC

Ms. Sexton stated that this is a request for approval of a communitization agreement with Athena Energy of Butte. The parcel is 40 acres of school trust land. The state owns 27.36 percent of the communitized area and would receive 3.42 percent of all gas production.

Motion made by Mr. Johnson to approve the communitization. Seconded by Ms. McCulloch. Carried unanimously.

508-8 OTTER CREEK – REQUEST TO START LEASING REVIEW

Ms. Sexton stated that this item is a request for the DNRC to initiate the appraisal and leasing review process for the Otter Creek coal tracts. The parcels total 8263.62 acres in Otter Creek units 1, 2 and 3. There have been substantial expressions of interest related to leasing the state's coal property in the Otter Creek area. Three main factors for the interest are:

- ♦ the decision to grant approval for the remaining section of the Tongue River railroad;
- ♦ that Great Northern Properties, which has a co-development agreement and owns the other half of the property, has indicated that it is in a position to move forward with development of the coal tracts in either a leasing or an equity basis; and
- ♦ the demand for high BTU coal and developing technologies for higher sodium coal.

Given the interest, it is an opportune time to move forward with getting an appraisal and providing the financial information necessary to determine the minimum bid terms that achieve fair market value for the Common School Trust. This is the first of many steps in the process. Once the appraisal were complete the proposal would return to the Land Board for consideration of the next step. The DNRC has funding for the appraisal.

Beth Kaeding, Northern Plains Resource Council Chair, stated that Northern Plains is a grass-roots conservation and agricultural organization that organizes Montana citizens to protect water quality, family farms and ranches, and the unique quality of life. She stated that NPRC was formed 36 years ago in response to proposals to industrialize southeastern Montana by strip-mining coal and building coal-fire generation plants.

The proposal to begin the leasing review process on Otter Creek is of great concern to NPRC. The Otter Creek lands were acquired by the state in the 1990s at the insistence of [then] Governor Marc Racicot for the perceived loss of mining jobs as part of the agreement to retire the hard rock mining claims in the New World Mining District, northeast of Yellowstone National Park. The federal government did not agree with the state of Montana's premise that it was owed for jobs that might never materialize, but agreed to compensate the state for the perceived loss in order to finalize the New World Mine deal. The federal government offered many different land trade options to the state in lieu of the Otter Creek tracts, most of which were located near active mining operations. The federal government felt that the area around Otter Creek had severe environmental consequences due to mining, as documented by the USGS, but Governor Racicot insisted on Otter Creek.

The Minerals Management Bureau of the DNRC compiled scientific information on Otter Creek, and noted that there are many things contained therein that ought to be considered before beginning this review process:

- ♦ Most of the State lands lie in the alluvial valley of Otter Creek and mining in alluvial valleys is not permitted as it will affect shallow aquifers.
- ♦ Otter Creek coal is high in sodium and ranges from two percent to nine percent. Wyoming has lower sodium coal, and when coal above 4 percent is sold, a discount must be taken or the coal may not be sold at all.
- ♦ The coal seams that do extend out of the alluvium and under the surrounding hills have a substantial overburden. In most Montana coal mines, for every cubic yard of coal recovered, there is a cubic yard of overburden to remove. At Otter Creek the overburden averages 3.75 cubic yards and can be as high as 6 cubic yards for every cubic yard of coal obtained

MAY 19, 2008
LAND BOARD MINUTES

- ♦ Mining the coal would require long haul mining which has associated subsidence problems.
- ♦ The lands around Otter Creek have high clay content, and would have high reclamation costs (if reclamation is even possible). NPRC does not believe that federal or state coal strip-mine reclamation laws can be met if these lands are mined.
- ♦ The Otter Creek area is part of the Powder River and Tongue River Basins which are slated for coal bed natural gas development. Any proposal to strip mine coal at Otter Creek must be considered with the cumulative impacts of this.

NPRC requested that the Land Board not take this first step for approving the leasing of the Otter Creek coal tracts and waste taxpayer money on an appraisal of Otter Creek that will falsely assess the value of this coal. If there is no railroad there (and NPRC will fight to ensure one is never built) then the coal is not as marketable as other coal in the region. Reclamation of the land following the mining will be difficult or impossible, surface and groundwater resources will be irreparably harmed, and the cumulative impacts to all Montana's resources in the area when the development of coal bed methane is considered will be staggering. Leasing the Otter Creek coal tracts is not in the best interest of the state or the state's schools and the appraisal money would be better spent on investing in removal projects that will bring sustainable monies to the school fund.

Mark Fix, rancher/past-chair of the NPRC, stated his ranch would be crossed by about three miles of the proposed Tongue River railroad, and that he would be faced with the proposed threat of condemnation of his land if he does not accept railroad's offer.

The last time development was discussed was during the 2004 election. Mike Gustafson, President of Wesco Resources, gave support to Pat Davidson to run for Governor, and Mr. Davidson brought up the development of Otter Creek tracts and Tongue River railroad. Mr. Davidson met with the representative from the state fish hatchery and informed them that the Tongue River Railroad could not put up a bond for the fish hatchery. Later it was discovered that the fish hatchery was given to the state from the federal government, and that if anything happened to the hatchery, the state would have to reimburse the federal government \$30 million. Mr. Gustafson had multiple investors, including funding from Chase Manhattan Bank.

Pittsburgh Minerals, a subsidiary of Chevron, spent several million dollars trying to develop Otter Creek and build the Tongue River Railroad, but finally realized that it was not a worthy investment and sold out. NPRC has challenged Tongue River II, and with the approval Tongue River III, the case is being reactivated in the Ninth Circuit Court. The EIS for Tongue River II is inadequate, and has used outdated studies. The Tongue River railroad will be devastating to the Tongue River Valley and NPRC will fight it from being developed every step of the way.

Former Governor Marc Racicot led Montana into the Otter Creek tracts. Racicot had the choice to trade minerals from the Crown Butte Mine for land near Colstrip or Decker, but instead insisted on obtaining the Otter Creek minerals. Former Governor Racicot is currently on the board of Burlington-Northern Railroad, which is providing seed-money to the Tongue River Railroad (according to a deposition given by Mike Gustafson).

The environmental impacts studies did not look at industrialization of the Tongue River and Otter Creek areas. No-dig standards for coal bed methane are currently being exceeded on the Tongue River during 2008 for the months of March and April. Mr. Fix cited the EIS and said if the Tongue River Railroad were ever built, it would move one million cubic yards of dirt per mile for 17 miles below the Tongue River Dam. Twenty thousand tons of sediment would be brought into the Tongue River, with a projection of between 5000 and 10,000 tons per year of additional

MAY 19, 2008
LAND BOARD MINUTES

sediment after completion of the railroad. No analysis has been done on additional sediment from the Tongue River Railroad route below the western alignment, nor has any analysis been done on the additional sediment load that will come from the Otter Creek area if the mine is developed, further degrading the water quality. The EAs do not account for cumulative impacts. Governor Schweitzer attended the dedication of the Tongue and Yellowstone Diversion Dam (12-Mile Dam) upstream bypass which opened last summer. Last month, FWP netted for 24 hours and counted 2200 fish going upstream past the diversion dam. The water quality from methane pollution in this proposed development could stop the fish from spawning. The endangered pallid sturgeon used the Tongue River for spawning over 100 years ago before the diversion dam was put into place. Mr. Fix noted that the Tongue River could supply a lifeline for the fish, but not if the Otter Creek and Tongue River railroad developments occur.

Mr. Fix expressed concern regarding the fires caused by railroads and recalled a fire from the previous year that burned several sections on his own and neighboring properties, jumped the river, and approached his home. The railroad is proposed for areas which have no road access, and Mr. Fix speculated that the state or county would have to build roads in order to be able to quickly access fire hazards.

The Tongue River Valley is a rich agricultural area that sustains farmers and ranchers, as well as several communities in southeastern Montana in an area rich in cultural history and wildlife resources. The proposed developments are "get rich quick" schemes for a few individuals. The proposed Otter Creek development would not solve the school funding crisis and revenue for the schools could actually be diminished due to lost coal revenue and jobs. The expense of the proposed analysis should be spared and the monies spent on our children now. Mr. Fix expressed concern about the current school funding system, referencing his own school-age children. He urged the Land Board to save approval for a later date when Otter Creek development is more certain.

Jeff Barber, Montana Environmental Information Center, asked the Land Board to deny the request to begin leasing review. Should the proposal move forward there are still a number of things to clarify, including:

- ♦ Why no assessment was performed during 2006 when a \$300,000 study of Otter Creek was done?
- ♦ The artificial inflation of the appraisal value due to the fact that the appraisal will be completed as if the Tongue River Railroad was already in existence. MEIC maintains that the development and feasibility of Otter Creek should not be tied to the permitting extension of the Tongue River Railroad.
- ♦ Who has been expressing interest in the Otter Creek tracts? Mr. Barber cited numerous companies that have come and gone without acting on the project, including Montcoal whose permit was revoked due to lack of development.

Julia Page, Northern Plains Resource Council, urged the Land Board to deny the Otter Creek proposal and stated that the project perpetuates old technology as the coal would be processed in existing plants that may not have the means to effectively capture and sequester carbon. New technologies should be considered due to the growing concerns over global warming.

Alan Joscelyn, representing CoalMont, an affiliate of Wesco, which has applications pending for the proposed development, stated that CoalMont appreciates and supports moving forward with Otter Creek. It is a logical and necessary step forward for the Land Board and its trust obligation of determining the value of an asset.

MAY 19, 2008
LAND BOARD MINUTES

Motion made by Mr. Johnson to approve the request to initiate the appraisal and leasing review process of Otter Creek. Seconded by Governor Schweitzer.

Governor Schweitzer asked if the more revenue generated by trust land automatically means more money for the schools or if there were additional steps to funding the education system?

Ms. McCulloch verified that more revenue generated by trust land activity does not automatically equal greater funding for schools, and stated that trust land revenue comprises approximately ten percent of education funding.

Governor Schweitzer referenced previous legislative sessions, where K-12 education funds were reduced and asked if the Land Board had hypothetically sold all 5.2 million acres of trust land, would that have impacted the amount of money allocated to the schools?

Ms. McCulloch stated it would not have affected the monies granted by the legislature for K-12 education. The legislature uses the money made by the trust as a basis from which to start building funding for Montana's schools. OPI then distributes the monies to the schools.

Governor Schweitzer stated that understanding how the process of school funding works is instructive information for people who are campaigning for office during this election year and helps to eliminate redundant discussions.

Mr. Johnson stated that it was his understanding that a precedent had already been created that would allow different classes of revenue to be treated in different ways. He cited the example of revenue generated from the harvest of timber being treated differently than revenue generated by non-timber dollars. Timber dollars are designated as net new dollars and the non-timber dollars as replacement dollars. The Land Board has reason to believe that with a substantial new source of income, the legislature could be expected to allocate at least some of that to the public education system.

Mr. McGrath referenced Mr. Barber's statement regarding the Tongue River Railroad and asked if the Otter Creek appraisal would be would be done assuming access?

Ms. Sexton said that all appraisals are conducted with the understanding that the state always has access to whatever is being considered. She also clarified Mr. Barber's earlier reference to the \$300,000, stating that those monies were legislative appropriation to assess the quality of the coal resource, whereas the proposed appraisal is to assess fair market value given the information determined by the earlier assessment.

Mr. McGrath asked if the value of the resource would be diminished without access?

Ms. Sexton said yes.

Mr. Morrison agreed that additional revenue does not equal additional available funds for the schools. He also stated that the issue of development that might occur subsequent to the proposed assessment is not related to the extension of the railroad from Ashland to Decker. The railroad from Ashland to Decker implicates very significant environmental and labor issues, including building a berm through the pristine valley and connecting Wyoming coal to a northern transportation route which could adversely effect Montana labor. Mr. Morrison asked the DNRC to develop documentation that specifically addresses the concern that any future leasing might create a presumption or ratification of the idea of building this entire railroad down to Decker.

MAY 19, 2008
LAND BOARD MINUTES

Mr. Johnson stated that there may be an excessive amount of “what if” querying occurring and it is unrealistic to assume that coal of the caliber in the Otter Creek area will not be a significant part of the country’s energy portfolio. The Land Board has a responsibility to move forward the process and determine if it is economically and environmentally feasible to develop the Otter Creek resource.

Governor Schweitzer stated that the Land Board has a fiduciary responsibility to manage the assets of the state and to find long-term revenue. Nearly all of the Land Board’s decisions have been unanimous, including previous discussions of development at Otter Creek. Private coal owners have expressed the concern that the state is trying to make its coal development a higher priority than the private coal owners. Another concern is that there is greater coal production than rail capacity, so developing a railroad extension into Decker would place Wyoming coal owners at a competitive advantage despite Wyoming’s coal resources being less than Montana’s. If a railroad were built only to the Otter Creek area, the revenue generated by the potential mining might not validate having built such a railroad, in fact the results could be deleterious.

Pat Davidson had presented the Otter Creek coal beds as the solution to every financial challenge faced by the state and that it was only later discovered that he had an equity share in developing the Otter Creek area. Governor Schweitzer stated his belief that it is in the best interest of the state and incumbent upon the Land Board to spend the money to determine the potential market value of the Otter Creek assets. There has been interest expressed by various companies, including Great Northern Properties, the largest coal holder in America. Since tracts owned by the state are located in a rather checkerboard fashion with other owners, it is challenging to proceed without the full cooperation of other entities. Proceeding with the appraisal and review process is the only way to determine some of the answers to the questions raised:

- ♦ the value of the coal
- ♦ the need for a railroad
- ♦ the interest of other parties
- ♦ the actual market for higher sodium coal
- ♦ if technologies are emerging to render the higher sodium coal more acceptable in the market

Governor Schweitzer expressed his belief that the Land Board has found ways to agree to maximize the value of the state’s assets: it is owed to the current and future generations of Montanans to know the asset’s value. The Governor stated his support in moving forward in the process. At later date the Land Board could examine what some of the intended or unintended consequences may be.

Motion to initiate appraisal and leasing review process carried unanimously.

508-9 RIGHT-OF-WAY APPLICATIONS

Item 508-9 was considered as a single block.

508-9A RIGHTS-OF-WAY

Ms. Sexton stated that the applications were for an historic telephone utility; new electric utility; new telephone utilities; new gas pipeline; and an historic private access road.

MAY 19, 2008
LAND BOARD MINUTES

508-9B U.S. FOREST SERVICE COST/SHARE RIGHT-OF-WAY

Ms. Sexton stated that this is a reciprocal cost/share agreement since state forest lands are intermingled with USFS lands and it is necessary to exchange easements. The exchange is provided for in the master agreement with the USFS. Ms. Sexton stated that this easement will allow the state access to 1500 acres of state trust lands. The costs owed to the USFS would be \$36,650. The agreement provides for maintenance as well as access.

Motion made by Mr. Morrison to approve the rights-of-way and cost/share agreement.
Seconded by Ms. McCulloch. Carried unanimously.

Motion to adjourn made by Mr. Morrison. Seconded by Governor Schweitzer.